



Business Organizations Supplementary Materials (Part 1)

Professor Jeffrey MacIntosh
Faculty of Law
University of Toronto

Fall 2003

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BUSINESS ORGANIZATIONS SYLLABUS (Part 1)

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INTRODUCTORY STUFF

CLASS SCHEDULE

Tuesday and Thursday, 10:10 AM – 12:00 PM

MATERIALS

1. Ziegel, Daniels, MacIntosh & Johnston, Cases and Materials on Partnerships and Canadian Business Corporations (Toronto: Carswell, 1994) (referred to below as “Ziegel”)
2. Canada Business Corporations Act (“CBCA”), 2003 (referred to below as “CBCA”)
3. MacIntosh, Business Organizations Supplementary Materials, Fall 2003 (referred to below as “Supp.”)

OFFICE HOURS

My office hours are Tuesday and Thursday, 3:00 – 5:00 PM (unless I indicate that I will not be available in either of those slots, in which case I will try to specify an alternative time). My office is Room 421 in Flavelle House (one of the decadently outfitted new offices on the third floor of the building).

THE BREAK

We will take a break at approximately 11:00 AM each class day. Please note that since I am hypoglycemic, I often disappear to my office during the break in order to inhale a sandwich and keep my blood sugar where it should be (alternatively, I munch down a sandwich while asking questions). Hence, if you see me shooting out of the classroom at break time (or eating in your face), please don't take it personally!

DOING RESEARCH ON CORPORATE LAW

The various statutes (and regulations), including the CBCA and other corporate statutes, may be found in a variety of sources. The web site http://www.lexum.umontreal.ca/index_en.html allows you to search all of the laws of the federal government and the provinces on-line. Further, the CBCA may be accessed at <http://laws.justice.gc.ca/en/C-44/index.html>. In addition, all jurisdictions have their own official legislative web sites. Quicklaw also contains a database with all federal and provincial laws. A word of caution, however; these on-line sources (even the official provincial and federal web sites) may not be entirely up to date. Cases may be found in searchable form on Quicklaw, as well as in the CCH Canadian on-line materials. U.S. materials are accessible on either Westlaw or LEXUS/NEXUS. The library will give you a free password for any of these on-line services.

With respect to Canadian textual materials, there are regrettably few sources, and no entirely up-to-date source. The most recent and perhaps the most student-friendly is Anthony VanDuzer, The Law of Partnerships and Corporations (Toronto: Irwin, 1997), which tracks this course quite closely in terms of its organization and selection of cases. You might also want to look at Bruce Welling, Corporate Law in Canada, the Governing Principles (2d ed.) (Toronto: Butterworths, 1991) (which is now somewhat outdated, especially for oppression remedy cases); Tom Hadden, Robert E. Forbes, and Ralph L. Simmonds, Canadian Business Organizations Law (Toronto: Butterworths, 1984) (which is even more outdated); and Frank Iacobucci et al., Canadian Business Corporations: An Analysis of Recent Legislative Developments (Agincourt, Ont.: Canada Law Book, 1977) (yet more outdated, but containing the most useful policy analysis). The best Canadian corporate law text ever written (at least from a black letter law perspective)

is, without question, Franklin W. Wegenast, The Law of Canadian Companies (Toronto: Burroughs and company, 1931). While it is rarely now consulted because of its date of publication, it is tremendously useful for research on Canadian and English company law up to 1931.

For English law, see Brian R. Cheffins, Company Law: Theory, Structure, and Operations (Oxford: Clarendon Press, 1997); L.C.B. Gower, Gower's Principles of Modern Company Law. The first contains cases as well as a sophisticated law and economics analysis of the cases. The second has for a long time been the standard black-letter reference textbook that is widely cited by the courts and that I have often found very useful.

EVALUATION

Evaluation will be by a 3-hour open book examination that will consist of a combination of essay, fact pattern and short answer questions. While in the past I have tended to examine only on black-letter law issues (i.e. what do the cases and statutes say), this year I will also have a policy-oriented essay question. Also note that I will *not* be using multiple choice questions on this year's exam (pure self-interest: I still have rope-burn from the last attempted lynching).

THE SYLLABUS

MODULE 1: INTRODUCTION TO CORPORATE LAW AND CORPORATE GOVERNANCE

Reading: Ziegel, pp. 389-406, 439-452, 247-251

1. Introductory Concepts

- a. Outline of Constituencies with an Interest in the Corporation (purpose: to define the scope of corporate law, as opposed to other branches of the law)
- b. What is a common share? A preferred share? A bond? How do these differ in risk and expected return? How many permutations and combinations of rights can you have?

CBCA ss.23, 24

- c. What is a “private” company? A “public” company? (and the correlative concepts of “distributing” and “non-distributing” corporations in the CBCA)

CBCA ss. 2(1) (definition of “distributing corporation”)

- d. Capital Markets; Primary and Secondary (including a brief description of the Canadian stock exchanges)
- e. Types of Traders: Retail and Institutional
- f. The Constitutional Basis of Provincial and Federal Corporate Law (Constitution Act, s.92(11), and s.91 - POGG)
- g. The Regulatory Landscape: The Corporate Regulators and the Securities Regulators

CBCA ss. 2(1) (definitions of “Director” and “director”)

2. *The Legal Model of “Corporate Governance”: Shareholders as Owners, Directors and Officers as Agents (shareholders rule, okay?)*

CBCA s.102 (directors to manage or supervise management)
CBCA ss. 106(3) (shareholders to elect directors)
CBCA Part XV (“Fundamental Changes” – do a quick skim
just to get an idea of what kinds of fundamental changes
shareholders get to vote on)

3. *The Nihilist View of Berle and Means (Adolf A. Berle and Gardiner C. Means, The Modern Corporation and Private Property (1932)) et al.*

- a. separation of ownership and control
- b. “collective action” and “free riders” problems
- c. management as self-perpetuating satrapy
- d. shareholders as disinterested sheep, shareholder voting as useless exercise
- e. agency costs: shirking and perquisite consumption

4. *Responses to Berle and Means*

- a. Outside, Independent, and Unrelated Directors

CBCA ss. 102(2)

- b. Market discipline of Management (product, capital, control, and managerial labour markets)
- c. Institutional Investors

5. *The Role of Corporate Law*

- a. The Overriding Efficiency Goal (allocative efficiency, transactional efficiency, and informational efficiency, low agency costs)
- b. The Two Competing Views of the Purpose Served by Corporate Law
 - i. The Mandatory and Enabling Views

- ii. The Different Mechanisms of the Mandatory and Enabling Views
 - iii. The Different Efficiency Premises of the Mandatory and Enabling Views
- c. Does the Empirical Evidence Favour One View or the Other?
- d. The Charter Shopping Debate in Corporate Law: A Joint Test of Whether Law Matters and Whether the “Charter Market” is Good or Bad

Ziegel, pp. 247-251

6. *Different Forms of “Off-the-Rack” Rules: Corporations, Partnerships, Limited Partnerships, Sole Proprietorships*

MODULE 2: MORE INTRODUCTORY CONCEPTS

Reading: Ziegel, pp. 253-269

1. *More Introductory Concepts*

- a. *The Corporate Constitution: The Articles of Incorporation, the By-Laws, and the Unanimous Shareholder Agreement* (and their analogues in Memorandum Jurisdictions and Letters Patent Jurisdictions)

CBCA ss. 2(1), 146 (definitions of “articles”, “unanimous shareholder agreement”)

CBCA 103 (by-laws)

Ziegel pp. 259-261, 263-268

- b. *Annual Meetings and Special Meetings*

CBCA ss 133, 135(5), 165 (removal of auditor at special meeting)

c. *Ordinary and Special Resolutions*

CBCA ss. 2(1) (definitions of “ordinary” and “special” resolution)

d. *De Jure and De Facto Control*

e. *“Management Controlled” Corporations*

MODULE 3: THE TRADITIONAL MODEL OF CORPORATE GOVERNANCE AND ITS CRITICS

1. *The Black Letter Legal Model of the Corporation*

a. *The Powers of Shareholders and the Powers of Directors*

General: Ziegel, pp. 406-439

CBCA ss.102, 103

Kelly v. Electrical Construction (1907), 16 O.L.R. 232 (Ch. D.) (Ziegel, pp. 407-409)

Continental Securities v. Belmont, 99 N.E. 138 (N.Y.C.A. 1912) (Ziegel, pp. 409-411)

Note (Ziegel, p. 411)

NOTE: *Continental* raises the question of what powers shareholders are given by statute. Some of the most important shareholder powers in the CBCA are:

CBCA ss. 106(3) (election of directors)

CBCA s.109 (removal of directors)

CBCA Part XV (“Fundamental Changes”)

Common law shareholder power to ratify voidable acts of directors (see Chapter 7 re fiduciary duties)

CBCA ss. 135(5) (at annual meeting, shareholders elect the auditor, and must approve the annual financial statements)

CBCA s.137 (shareholder proposals)

CBCA s. 137(1)(b) (shareholder right to discussion)

b. *Are Directors the Legal Agents of Shareholders?*

Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuninghame, [1906] 2 Ch. 34, 75 L.J. Ch. 437 (Eng. C.A.) (Ziegel, pp. 411-413)

Notes and Questions (Ziegel, pp. 413-415)

Notes on By-Laws (Ziegel, pp. 415-416)

NOTE: the *Cuninghame* case took place in a *memorandum* jurisdiction. Note the two differences from articles of incorporation jurisdictions; i) shareholders possess residual powers; ii) “contractual” basis of memorandum companies.

c. *Internal Delegation of Directors’ Powers*

Note (Ziegel, pp. 416-417)

Hayes v. Canada-Atlantic & Plant S.S. Co., 181 F. 289 (1st Cir. 1910) (Ziegel, pp. 417-419)

Notes (Ziegel, pp. 419-420)

CBCA ss.115, 121, 122(1)

Question: Are *Hayes* and the CBCA provisions governing delegation mutually exclusive?

Question: Is *Hayes* binding on Canadian courts?

d. *External Delegation of Directors’ Powers*

Sherman & Ellis v. Indiana Mutual Casualty, 41 F.2d 588 (7th Cir. 1930) (Ziegel, pp. 420-422)

Kennerson v. Burbank Amusement Co., 260 P.2d 823 (Calif. C.A. 1953) (Ziegel, pp. 422-423)

Question (Ziegel, p. 423)

CBCA ss.102, 122(1)

Question: Are there policy reasons for placing limits on external delegation?

e. *Employment Contracts and Director/Officer Tenure*

Note (Ziegel, p. 423)

Realty Acceptance Corp. v. Montgomery, 51 F.2d 636 (3rd Cir. 1930) (Ziegel, pp. 424-426)

Southern Foundries v. Shirlaw, [1940] 2 All E.R. 445, [1940] A.C. 701 (H.L.) Ziegel, pp. 427-430)

Shindler v. Northern Raincoat, [1960] 2 All E.R. 239, [1960] 1 W.L.R. 1038 (noted in Ziegel, p.430)

Notes (Ziegel, pp. 430-431)

CBCA ss. 106(3), 121

f. *Removal of Directors*

CBCA ss. 6(4), 109, 140(1), 24(3), (4)

Note (Ziegel, p.432)

Bushell v. Faith, [1970] A.C. 1099, [1970] 1 All E.R. 53 (H.L.) (Ziegel, pp. 432-438)

Questions: Was the House of Lords correct on legal grounds? Were they correct purely from a policy perspective? What would the result be if *Bushell* was litigated in Canada?

Questions (Ziegel, p. 438)

Note on Officers (Ziegel, pp. 438-439)

Note on USAs (Ziegel, p. 439)

2. *A Critique of the Legal Model: What Do Directors Really Do? What Can They be Expected to Do?*

Ziegel, pp. 439-449

Ziegel, pp. 511-517

Note: We will already have discussed some of the limitations of the traditional model in Module 1. The articles in these readings amplify some of the themes that we will already have discussed.

MODULE 4

1. *The Fundamental Characteristics of Corporations*

CBCA ss.5, 8, 9, 15, 16, 17, 18, 45

Supp. pp. 2 ((Canada) Interpretation Act, s.21)

2. *Why Incorporate (versus carrying on business in some other form)?*
 - a. All of the above fundamental characteristics, but especially limited liability and perpetual succession (which facilitates estate planning)
 - b. More elaborated “off-the-rack” rules
 - c. Tax considerations

- d. Generally, easier transferability of rights
- e. Allows for creation of greater range of investment instruments
- f. Disciplinary structure
- g. Use of shares as “currency” to effect acquisitions (especially for public companies)
- h. Ability to use shares/options etc. as managerial incentives (especially public companies)

3. *Disadvantages for Private Corporations*

- a. Cost of incorporating (minor problem)
- b. Formalities (directors and shareholders meetings, minute books of directors and shareholders meetings, share registers, etc).
- c. Financial Statements (CBCA s.155) (publicly filed for distributing corporations per CBCA s.160)
- d. Restrictions on Foreign Directors (e.g. CBCA 105(3), (4))

4. *Disadvantages for Public Corporations*

- a. All of the above
- b. Cost of going public (especially prospectus cost)
- c. Application of securities regulation (applies mostly, although not exclusively to public corporations); significantly increases the cost of carrying on business
- d. Cost of public disclosure/public relations
- e. Enhanced exposure to minority shareholder suits/class actions
- f. Loss of confidentiality via public disclosure requirements

MODULE 5: The Nature of Corporate Legal Personality and its Consequences

1. *Introductory Concepts*

- a. The corporate balance sheet
- b. Nominal or authorized capital versus issued capital

c. Floating charge security

2. *The Corporation as a Separate Legal Entity*

Salomon v. Salomon & Company, [1897] A.C. 22, 66 L.J. Ch. 35 (H.L.) (Ziegel, pp. 116-122)

Notes (Ziegel, pp. 122-123)

Question: How could the nominal sale price have been [pounds] 40,000, when the company was only worth a fraction of that?

Question: How important was it that at the time the incorporation all “old” creditors were paid off?

Question: Should the court have subordinated the debenture to the interests of other creditors, given that Salomon was a shareholder as well as the principal creditor (i.e. should there be “equitable subordination”)?

Question: What is the *ratio* of *Salomon*? Did it create limited liability for corporations?

3. *The Consequences of Legal Personality (or lack thereof); Corporations versus Partnerships*

Lee v. Lee’s Air Farming, [1961] A.C. 12, [1960] 3 All E.R. 420 (P.C.) (Ziegel, pp. 124-126)

Re Thorne and New Brunswick Workmen’s Compensation Board (1962), 33 D.L.R. (2d) 167 (N.B.S.C., A.D.) (Ziegel, pp. 43-48)

Notes (Ziegel, pp. 48-52)

Question: Do the contrasting results in these two cases make sense from a policy point of view?

4. *The Consequences of Legal Personality: Insurance (and the Shareholder's Interest in Corporate Assets)*

Macaura v. Northern Assurance Co. Ltd., [1925] A.C. 619, [1925] All E.R. Rep. 51 (H.L.) (Ziegel, pp. 126-129)

Kosmopoulos v. Constitution Insurance Co. (1983), 149 D.L.R. (3d) 77 (Ont. C.A.) (Ziegel, pp. 129-135)

Kosmopoulos v. Constitution Insurance Co., [1987] 1 S.C.R. 2 (S.C.C.) (Ziegel, pp. 135-136)

Note (Ziegel, pp. 136-137)

Questions: What are the policy reasons for and against allowing a single shareholder to insure the assets of the company? What is the danger inherent in giving the kind of remedy given by the court in the *Kosmopoulos* case? Are there any other doctrines that the court might use to reach the same result that the court reached?

5. *Disregard of Corporate Personality in Corporate Law*

Ziegel, pp. 156-171, 176-199

Excerpts from Jeffrey G. MacIntosh, "Disregard of Corporate Personality in Canada" (Supp. p. 3)

Question: which of the three classifications explored in MacIntosh do the following cases fall into?

Mesheau v. Campbell (1983), 39 O.R. (2d) 702 (O.C.A.) (Ziegel, pp. 156-157)

Notes (Ziegel, p. 158)

Clarkson Co. Ltd. v. Zhelka, [1967] 2 O.R. 565 (Ont. H.C.) (Ziegel, pp. 167-171)

Rockwell Developments Ltd. v. Newtonbrook Plaza Ltd., [1972] 3 O.R. 199 (Ont. C.A.) (Ziegel, pp. 176-176-180)

Note 2 (Ziegel, pp. 181-182)

De Salaberry Realities Ltd. v. MNR (1974), 46 D.L.R. (3d) 100 (Fed. T.D.) (Ziegel, pp. 182-191)

Covert v. Nova Scotia, [1980] 2 S.C.R. 774 (noted in Ziegel, p. 191-193)

Minister of National Revenue v. Blackburn (1976), 66 D.L.R. (3d) 191 (Fed. C.A.) (note 4 in Ziegel, p. 195-196)

Manley v. Fallis (1977), 2 B.L.R. 277 (Ont. C.A.) (Ziegel, pp. 197-199)

Questions (Ziegel, pp. 199)

6. *Disregard of Corporate Personality in Tort Law*

a. *Imposing Tortious Liability on Directors: General*

ScotiaMcLeod Inc. v. Peoples Jewellers Limited, (1995), 26 O.R. (3d) 481 (Ont. C.A.) (Supp. p. 19)

b. *The Tort of Inducing Breach of Contract*

Ontario Store Fixtures Inc. v. Mmmuffins Inc. (1989), 70 O.R. (2d) 42 (H.C.J.) (Supp. p. 26)

7. *Analytical Perspectives on Limited Liability*

Halpern, Trebilcock and Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980), 30 U.T.L.J. 117 (Ziegel, pp. 163-166)

Richard Posner, *Economic Analysis of Law* (4th ed., 1992), 14.5 (Ziegel, pp. 210-213)

8. *Ultra Vires, Constructive Notice, and the Indoor Management Rule*

CBCA ss. 15-18

MODULE 6; CORPORATE GOALS AND SOCIAL RESPONSIBILITY: TO WHOM ARE DIRECTORS' DUTIES OWED?

CBCA s. 122

Dodge v. Ford Motor Company, 204 Mich. 459, 170 N.W. 668, 3 A.L.R. 413 (Del. Ch. 1919) (Ziegel p. 322 and notes, 325-327)

Parke v. Daily News, [1962] 1 Ch. 927, [1962] 2 All E.R. 929 (Ch. D.) (Ziegel 328-335, and notes 335-337)

Peoples Department Stores Inc. (trustee of) v. Wise, [2003] Q.J. No. 505 (Que. C.A.) (Supp. p. 29)

Theodora Holdings Corp. v. Henderson, 257 A. 2d 398 (Del. Ch. 1969) (Ziegel 337, and notes 341-341)

Notes and Excerpts from articles, Ziegel p. 341 (note), 342-343 (Dodd), 345-347 (Posner), 347-348 (Mundheim)

MODULE 7: THE DUTY OF CARE OWED BY OFFICERS AND DIRECTORS TO THE CORPORATION

1. *Common Law*

Re City Equitable Fire Insurance Co. Ltd., [1925] 1 Ch. 407 (Ch. D.) (Ziegel, pp. 453-457)

Note (Ziegel, p. 457)

Re Brazilian Rubber Plantations and Estates, Ltd., [1911] 1 Ch. 425 (C.A.) (Ziegel pp. 457-459)

Notes 2-5 (Ziegel, pp. 471-474)

2. *Statutory Reform: Due Diligence in the Income Tax Context*

Income Tax Act, s.227.1 (Supp. p. 34)

Soper v. Canada, [1998] 1 F.C. 1224 (F.C.A.) (Supp. p. 35)

3. *Statutory Reform: Corporate Law*

CBCA s. 122(1)(b)

Peoples Department Stores Inc. (Trustee of) v. Wise, [2003] Q.J. No. 505 (Que. C.A.) (Supp. p. 45)

4. *Statutory Reform: Environmental Obligations*

R. v. Bata Industries Ltd. (1992), 9 O.R. (3d) 329 (Ont. Gen. Div.) (Ziegel p. 503-509)

Notes (Ziegel, p. 509)

5. *The Securities Regulators' Public Interest Duty of Care*

Re Standard Trustco Ltd. (1992), 6 B.L.R. (2d) 241 (O.S.C.) (Supp. p. 54)

6. *The Multiplication of Statutory Director Liabilities*

Daniels and Morgan, "Directors Face Grab-Bag of Liabilities" (Financial Post, August 12, 1992 at 40) (Ziegel, pp. 509-511)

Notes (Ziegel, p.511)

7. *Indemnification and Insurance*

CBCA s. 124

Note (Ziegel, p. 521)

Daniels and Hutton, "The Capricious Cushion: The Implications of the Directors' and Officers' Insurance Liability Crisis on Canadian Corporate Governance" (1993), 22 Can. Bus. L. J. 182 (Ziegel, pp. 525-529)

Note (Ziegel, 529-530)

